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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SETH D. HARRIS, Acting Secretary of the United States Department of Labor, Plaintiff, v. GREATBANC TRUST COMPANY, et al., Defendants.	Case No. EDCV12-1648-R (DTBx) **DEFENDANT GREATBANC TRUST COMPANY'S REPLY IN SUPPORT OF ITS MOTION TO DISMISS COUNT II OF THE COMPLAINT** Date: March 4, 2013 Time: 10:00 a.m. Judge: Hon. Manuel L. Real Ctrm: 8

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GreatBanc Trust Company ("GreatBanc") submits the following Reply in Support of Its Motion to Dismiss Count II of Plaintiff Seth D. Harris, Acting Secretary of the Department of Labor's (the "Secretary") Complaint.

I. INTRODUCTION

The Secretary's Opposition admits that the sole case addressing the novel claim that Congress intended to create an unwritten rule into ERISA Section 410 precluding advancement of defense costs because of the potentiality of settlement rejected the notion. Indeed, the Secretary's own regulations promulgated under Section 410 and the long-standing views of the Department of Labor (DOL) contradict the Secretary's current assertion that Section 410 voids the indemnification provision in this case. Regulations and advisory opinions show that the official views of the DOL are considerably narrower than those advocated now. The DOL's interpretive regulations state that Section 410 applies only to agreements in which a benefit plan itself agrees to indemnify the fiduciary for fiduciary breach. An indemnity agreement in which a plan sponsor or others agree to indemnify a fiduciary of a plan is valid and enforceable. In fact, the DOL officially takes the position that a benefit plan itself may pay a settlement from plan assets where its fiduciary deems it in the Plan's best interests.

There is no distinction in the statute or regulations between a fiduciary of an employee stock ownership plan ("ESOP") and a fiduciary of any other kind of ERISA-governed plan. The Secretary's argument otherwise would improperly impose a different standard on ESOP fiduciaries that was not intended by Congress. ERISA's plan asset regulations demonstrate, without doubt, that corporate assets are not equivalent to plan assets, even in the case of a wholly-owned ESOP company. Thus, the Secretary's position that Sierra Aluminum Company Employee Stock Ownership Plan (the "Plan"), as Sierra Aluminum Company's ("Sierra") sole shareholder, is the true indemnitor under the indemnification agreement fails.

Nor does Section 410 or its interpretive regulation prohibit payment of settlements under an indemnification agreement. The Secretary's innovative, but unsupported, argument otherwise is unpersuasive. The Opposition provides no authority --case law or otherwise-- that bolsters the Secretary's position. Instead, the Secretary engages in pages upon pages of irrelevant philosophical discussion. At bottom, the Secretary fails to offer any plausible reason why this court should not follow the reasoning in *Martinez v. Barasch*, 01-CIV-2289, 2006 WL 435727 (S.D.N.Y. Feb. 22, 2006) and conclude that neither Section 410 nor its interpretive regulation prohibits payment of settlement amounts by an indemnitor.

The indemnification agreement complies with Section 410(a). GreatBanc's Motion to Dismiss Count II of the Secretary's Complaint should be granted without leave to amend.

II. ARGUMENT

A. The Secretary Failed to Allege Facts Sufficient to Establish That the Indemnification Agreement Violates Section 410

1. A Plan Sponsor Can Indemnify a Plan Fiduciary.

Whether a company is partially or wholly owned by an ESOP has no bearing on the validity of an indemnification provision under the controlling authority of the federal regulations. The Secretary advocates for a novel application of Section 410 to prohibit a company that is partially- or wholly-owned by an ESOP to indemnify a plan trustee. The Secretary's position would, if accepted, impose a different standard for indemnification of ESOP fiduciaries than fiduciaries of any other type of ERISA-governed plan. Nothing in ERISA supports this position.

An indemnification agreement does not violate ERISA Section 410 so long as it does not relieve a fiduciary from its responsibilities under ERISA. *Wells Fargo Bank v. Bourns, Inc.*, 860 F. Supp. 709, 714 (N.D. Cal. 1994); *see also* ERISA Section 410(a) (29 U.S.C. § 1110) (voiding "any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under" ERISA). Section 410 does not preclude indemnification agreements, such as that at issue here, which simply contemplate that a plan sponsor will advance defense costs where there has been no finding of a breach of ERISA fiduciary duties.

The DOL's official interpretation of Section 410(a) is much narrower than the Secretary suggests: "The Department of Labor interprets this section to permit indemnification agreements which do not relieve a fiduciary of responsibility or liability under part 4 of title I. Indemnification provisions which leave the fiduciary fully responsible and liable, but merely permit another party to satisfy any liability incurred by the fiduciary in the same manner as insurance purchased under section 410(b)(3), are therefore not void under section 410(a)." 29 C.F.R. § 2509.75-4. To be sure, the DOL has viewed indemnification arrangements with a benefit plan itself as violative of Section 410 where the agreement "would have the same result as an exculpatory clause, in that it would, in effect, relieve the fiduciary of responsibility and liability to the plan by abrogating the plan's right to recovery from the fiduciary for breaches of fiduciary obligations." *Id.* But even an agreement with a benefit plan itself may meet the DOL's standards where proper precautions are taken. *See* ERISA Advisory Opinion 77-66/67A (discussed *infra* at Section II.B).

GreatBanc's indemnification agreement explicitly *voids the agreement* if a court finds that a fiduciary breach occurred. Complaint ("Compl.") ¶ 61 ("However, these indemnification provisions shall not apply to the extent that any loss, cost, expense, or damage with respect to which any of the Indemnitees shall seek indemnification is held by a court of competent jurisdiction, in a final judgment from which no appeal can be taken, to have resulted either from the gross negligence or willful misconduct of one or more of the Indemnitees or *from the violation or breach of any fiduciary duty imposed under ERISA on any one or more of the Indemnitees.*") (emphasis added). As such, the indemnification agreement does not abrogate GreatBanc's liability in the event it actually breached its duties to the Plan (which it did not).

The regulations underscore that indemnification agreements like GreatBanc's are allowable under Section 410. 29 C.F.R. § 2509.75-4 provides that "Indemnification provisions which leave the fiduciary fully responsible and liable, but merely permit another party to satisfy any liability incurred by the fiduciary in the same manner as insurance purchased under 410(b)(3), are therefore not void under 410(a)." The regulation's first example of such lawful agreements mirrors Sierra's indemnification of GreatBanc: "Indemnification of a plan fiduciary by . . . an employer, any of whose employees are covered by the plan." *Id.*; *see also Perelman v. Perelman*, Civil Action No. 10-5622, 2013 WL 271817, at *8 (E.D. Pa. Jan. 24, 2013) (agreement where employer indemnified fiduciary found valid under "the safe harbor provided by 29 C.F.R. § 2509.75-4"). The Secretary does not argue otherwise. Because the indemnification agreement at issue here falls within the regulation's safe harbor, Count II of the Secretary's Complaint should be dismissed.

2. Sierra's Assets Are Not Equivalent to the Plan's Assets.

Sierra's assets are distinct from the Plan's assets. The Secretary argues in his Opposition (but does not allege in the Complaint) that because the Plan owns 100% of Sierra's stock, the Plan effectively would be the indemnitor in this case. Even if this statement was pled, it contradicts ERISA's regulations. The regulations explicitly define "plan assets" for plans with investments in the plan sponsor's stock. 29 C.F.R. § 2510.3-101(a)(1) (identifying special plan asset definitions for particular kinds of plan investments). Under the regulations, the Plan's equity interest in Sierra does *not* give it an interest in Sierra's corporate assets. The regulations specifically provide that "[g]enerally, when a plan invests in another entity, the plan's assets include its investment, but do not, solely by reason of such investment, include any of the underlying assets of the entity." *Id.* at § 2510.3-

101(a)(2). There is an exception where, as here, "the plan's investment [is] in an equity interest of an entity that is neither a publicly-offered security nor a security issued by an investment company . . . ." *Id.* However, that exception explicitly does not apply if "it is established that . . . [t]he entity is an operating company." *Id.* at § 2510.3-101(a)(2)(i). The Secretary has not alleged that Sierra is not an "operating company." Thus, ERISA precludes the Secretary's argument that Sierra's compliance with its obligations under the indemnification agreement is the equivalent of *the Plan* indemnifying GreatBanc. 29 C.F.R. § 2510.3-101(a)(2); *see also Armstrong v. Amsted Indus.*, No. 01 C 2963, MDL 1417, 2004 U.S. Dist. LEXIS 14776, at *20-21 (N.D. Ill. July 29, 2004), *rev'd on other grounds*, 446 F.3d 728 (7th Cir. 2006) ("Though the Amsted ESOP's assets are the shares of Amsted, properties acquired and owned by Amsted are not plan assets.").

3. Case Law and DOL Advisory Opinions Demonstrate the Secretary's Overreach.

Citing no case in support of his novel position, the Secretary instead misconstrues the cases GreatBanc relied upon in its opening memorandum. In *Johnson v. Couturier*, the Secretary's primary authority, the court's decision to invalidate an indemnification agreement turned on three facts not alleged here: (1) the indemnification agreement did not exclude breaches of fiduciary duties under ERISA; (2) plaintiffs had established that they would likely succeed in proving that the defendants breached their ERISA fiduciary duties; and (3) the plan sponsor was no longer an "operating company" because it had liquidated 100% of its assets for the benefit of the ESOP participants (making the plan asset regulations irrelevant and causing a situation where payments to indemnitees dollar-for-dollar reduced funds available to ESOP participants). *Couturier*, 572 F.3d 1067, 1078-81 (9th Cir. 2009). The allegations of the Complaint are just the opposite: (1) the indemnification agreement specifically excludes indemnity for breaches of ERISA fiduciary duties; (2) there has been no finding that the Secretary is likely to prove that GreatBanc breached its fiduciary duties under ERISA (and the Complaint's allegations actually indicate that the Secretary is unlikely to succeed); and (3) the Secretary has not alleged that Sierra is not a going concern or that GreatBanc could not reimburse the Plan if found liable for fiduciary breach.

The Secretary's reliance on *Donovan v. Cunningham*, 541 F. Supp. 276, 278 (S.D. Tex. 1982), *affirmed in part, vacated in part, reversed in part, on other grounds*, 716 F.2d 1455 (5th Cir. 1983), fails for the same reasons. The indemnification agreement in that case, like *Couturier*, did not exclude indemnity for breach of fiduciary duties, but only for "willful misconduct." *Cunningham*, 541 F. Supp. at 280. Further, *Cunningham*, disallowed corporate indemnification in an ESOP context without any reference to or analysis of the DOL regulations that specifically exclude corporate assets from the definition of an ESOP's assets. *See* Section II.A.2. In failing to acknowledge the governing authority on the definition of an ESOP's assets, *Cunningham* lacks persuasive authority. Similarly, the non-binding district court holding in *Fernandez v. K-M Indus. Holding Co., Inc.*, 646 F. Supp. 2d 1150 (N.D. Cal. 2009), also involved an indemnification agreement that did not carve out an exception for breach of fiduciary duty. *Fernandez*, 646 F. Supp. 2d at 1156.

These authorities therefore support GreatBanc's position that courts invalidate indemnification agreements only in two contexts: (1) where agreements indemnify conduct that ERISA prohibits and (2) where a court has determined that a breach of fiduciary duty occurred. Mot. 8:25-9:16. Because the Secretary failed to allege that either of two contexts where a court has found indemnification agreements void under Section 410 exists here, Count II should be dismissed.

B. Section 410(a) Does Not Invalidate Indemnification Agreements That Permit Payment of Settlements on Behalf of a Fiduciary

Adding on to its failure to recognize that an ESOP's assets do not include the underlying assets of the company the ESOP owns, the Secretary asserts that the possibility that GreatBanc could be indemnified in connection with a settlement could result in indemnification to a breaching fiduciary in violation of Section 410. In addition to contradicting the plan asset regulations discussed in Section II.A, *supra*, this argument would fail even if the underlying presumption that Sierra's assets were the ESOP's assets were true. Long-standing DOL opinions expressly permit the use of plan assets to satisfy settlements, so long as the plan's fiduciaries conclude that doing so is in the best interests of the plan's participants. *See* Department of Labor Prohibited Transaction Class Exemption 2003-39 (stating that "the Department has concluded that the statutory exemption in ERISA § 408(b)(2) may be available under limited circumstances for an exchange of [plan] property made solely to resolve claims arising out of the performance of an underlying service arrangement"); ERISA Advisory Opinion 99-12A (allowing a pension plan to make a settlement payment to a welfare fund so long as plan's fiduciaries acted prudently); ERISA Advisory Opinion 95-26A (holding that plans could exchange property in connection with a settlement of claims).

The DOL has explicitly determined that an indemnification provision substantially identical to the one between GreatBanc and Sierra did not violate Section 410 in the settlement context. In ERISA Advisory Opinion 77-66/67A, Equitable Life Assurance Society ("Equitable") requested an advisory or ruling that its indemnification agreement with an employer and the Central States, Southeast and Southwest Areas Pension Fund (the "Fund") did not violate Section 410. The agreement at issue provided for indemnification to "the fullest extent permitted by law," but explicitly carved out coverage in the event that "the final judgment of a court of competent jurisdiction" found Equitable to have breached its duties or responsibilities under ERISA. *Id.* at 20. With respect to advancement of defense costs, the agreement provided as follows:

> Expenses incurred in defending a civil or criminal action … shall be paid by the Trustees in advance of the final disposition of such

> action, suit or proceeding upon receipt of an undertaking by such person to repay such amount plus reasonable interest in the event that in the final judgment of a court of competent jurisdiction such person is found to have breached this Agreement or any duties or responsibilities….

Id. at 21.

The Department approved of this indemnification agreement, including its potential use in the settlement of a proceeding. Specifically, the Advisory Opinion found:

> [I]t is the opinion of the [DOL] that (1) the indemnification provisions in question do not contravene the provisions of section 410(a) of [ERISA], (2) payment by the [Fund] pursuant to the indemnification provision in settlement of pending or threatened litigation will not contravene the provisions of section 410(a) of ERISA if the Fund obtains a written opinion of independent legal counsel … that, based on a review of the relevant facts, the acts of the fiduciary in question do not constitute a breach of a fiduciary obligation by such fiduciary, [and] (3) reimbursement or payment by the Fund pursuant to the indemnification provisions of expenses properly and actually incurred (including reimbursement or payment of expenses properly and actually incurred in settlement of pending or threatened litigation) is not a prohibited transaction….

Id. at 21. Thus, even if Sierra's assets were assets of the Plan, it could constitute a proper use of plan assets to enter a settlement, provided procedural safeguards are taken to ensure that the transaction is in the best interests of the participants.

The Secretary's attempt to distinguish the case relied upon by GreatBanc, *Martinez v. Barasch*, 01-CIV-2289, 2006 WL 435727 (S.D.N.Y. Feb. 22, 2006), falls flat. The Secretary attempts to distinguish *Martinez* partially on the basis that the plaintiff was a co-trustee of the plan at issue, who would have had known about the indemnification clause and could have insisted on a "reallocation of attorneys' fees as part of the settlement." Opp. 20:24-21:3. The Secretary, however, omits critical context from his discussion of *Martinez*: the *Martinez* court discussed the co-trustee plaintiff's knowledge of an indemnification clause in the context of his decision to enter into settlement negotiations. *Martinez*, 2006 WL 435727, at *5. Just as in *Martinez*, if the Secretary chooses to enter into settlement negotiations with GreatBanc, he would be aware of the indemnification agreement between GreatBanc and Sierra and the Secretary could insist on reallocation as a part of the terms of a settlement. The Secretary has provided no persuasive reason why this court should not apply the *Martinez* court's reasoning and conclude that "settling defendants may generally enforce contractual indemnity rights without running afoul of ERISA," so long as the "specific contract provisions do not violate Section 410(a)'s prohibition against exculpatory indemnity clauses." *Id.*, at *5.

Finally, the Secretary's Opposition ignores a glaring fact: the Secretary has control of whether this case settles or proceeds to an adjudication on the merits. If the parties engage in settlement negotiations, the Secretary can condition a settlement on any terms he considers necessary to comply with ERISA, whether by insisting on an independent fiduciary (*see, e.g.*, PTE 2003-39; ERISA Advisory Opinion 77-66/67A), a payment directly from GreatBanc, or anything else. Defendants, of course, will remain free to decline to enter into a settlement and obtain an adjudication on the merits. In that event, the indemnification agreement's carve out for indemnification for fiduciary breach fully satisfies ERISA § 410 in the unlikely event the court finds a breach occurred.

C. The Secretary Did Not Allege in His Complaint That Sierra Lacks "Adequate Assurance" of Recovering Advanced Defense Costs from GreatBanc if Necessary

The Complaint contains no allegations about GreatBanc's ability to reimburse Sierra for advanced defense costs. The Secretary alleges only that the agreement require an "arrangement[] reasonably satisfactory" to Sierra for reimbursement of costs in the event of a breach. Compl. ¶ 61. Yet, in his Opposition, the Secretary claims that the indemnification agreement is invalid because there is not "adequate assurance" that Sierra can recover advanced defense costs if the court determines that GreatBanc breached its fiduciary duties. Opp. 23:18-24:4. Because the Complaint contains no allegations concerning even the actual existence of a reimbursement arrangement much less its adequacy, the Court should ignore the Secretary's argument for the purposes of deciding GreatBanc's Motion. *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003) (under Rule 12(b)(6) courts may consider only the contents of the complaint, documents attached to the complaint or incorporated by reference, or matters of judicial notice).

III. CONCLUSION

For the reasons discussed above, GreatBanc respectfully requests that the Court dismiss Count II of the Secretary's complaint without leave to amend.

Dated: February 15, 2013

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